

Internal Revenue Service, Treasury

§ 1.1374-10

Example 1. Separate determination of tax. (i) X is a C corporation that elected to become an S corporation effective January 1, 1986 (before section 1374 was amended in the Tax Reform Act of 1986). X has a net operating loss carryforward of \$20,000 arising in 1985 when X was a C corporation. On January 1, 1996, Y (an unrelated C corporation) merges into X in a transaction to which section 368(a)(1)(A) applies. Y has no loss carryforwards, credits, or credit carryforwards. The assets X acquired from Y are subject to tax under section 1374 and have a net unrealized built-in gain of \$150,000.

(ii) In 1996, X has a pre-limitation amount of \$50,000 on dispositions of assets acquired from Y and a taxable income limitation of \$100,000 (because only one group of assets is subject to section 1374, there is no allocation of the taxable income limitation). As a result, X has a net recognized built-in gain on those assets of \$50,000. X's \$20,000 net operating loss carryforward may not be used as a deduction against its \$50,000 net recognized built-in gain on the assets X acquired from Y. Therefore, X has a section 1374 tax of \$17,500 ($\$50,000 \times .35 = \$17,500$, assuming a 35 percent tax rate) for its 1996 taxable year.

Example 2. Allocation of taxable income limitation. (i) Y is a C corporation that elects to become an S corporation effective January 1, 1996. The assets Y holds when it becomes an S corporation have a net unrealized built-in gain of \$5,000. Y has no loss carryforwards, credits, or credit carryforwards. On January 1, 1997, Z (an unrelated C corporation) merges into Y in a transaction to which section 368(a)(1)(A) applies. Z has no loss carryforwards, credits, or credit carryforwards. The assets Y acquired from Z are subject to tax under section 1374 and have a net unrealized built-in gain of \$80,000.

(ii) In 1997, Y has a pre-limitation amount on the assets it held when it became an S corporation of \$15,000, a pre-limitation amount on the assets Y acquired from Z of \$15,000, and a taxable income limitation of \$10,000. However, because the assets Y held on becoming an S corporation have a net unrealized built-in gain of \$5,000, its net recognized built-in gain on those assets is limited to \$5,000 before taking into account the taxable income limitation. Y's taxable income limitation of \$10,000 is allocated between the assets Y held on becoming an S corporation and the assets Y acquired from Z for purposes of determining the net recognized built-in gain from each pool of assets. Thus, Y's net recognized built-in gain on the assets Y held on becoming an S corporation is \$2,500 [$\$10,000 \times (\$5,000/\$20,000) = \$2,500$]. Y's net recognized built-in gain on the assets Y acquired from Z is \$7,500 [$\$10,000 \times (\$15,000/\$20,000) = \$7,500$]. Therefore, Y has a section 1374 tax of \$3,500 [$(\$2,500 + \$7,500) \times .35 =$

\$3,500, assuming a 35 percent tax rate] for its 1997 taxable year.

[T.D. 8579, 59 FR 66469, Dec. 27, 1994, as amended by T.D. 8869, 65 FR 3856, Jan. 25, 2000]

§ 1.1374-9 Anti-stuffing rule.

If a corporation acquires an asset before or during the recognition period with a principal purpose of avoiding the tax imposed under section 1374, the asset and any loss, deduction, loss carryforward, credit, or credit carryforward attributable to the asset is disregarded in determining the S corporation's pre-limitation amount, taxable income limitation, net unrealized built-in gain limitation, deductions against net recognized built-in gain, and credits against the section 1374 tax.

[T.D. 8579, 59 FR 66470, Dec. 27, 1994]

§ 1.1374-10 Effective date and additional rules.

(a) *In general.* Sections 1.1374-1 through 1.1374-9 apply for taxable years ending on or after December 27, 1994, but only in cases where the S corporation's return for the taxable year is filed pursuant to an S election or a section 1374(d)(8) transaction occurring on or after December 27, 1994.

(b) *Additional rules.* This paragraph (b) provides rules applicable to certain S corporations, assets, or transactions to which §§ 1.1374-1 through 1.1374-9 do not apply.

(1) *Certain transfers to partnerships.* If a corporation transfers an asset to a partnership in a transaction to which section 721(a) applies and the transfer is made in contemplation of an S election or during the recognition period, section 1374 applies on a disposition of the asset by the partnership as if the S corporation had disposed of the asset itself. This paragraph (b)(1) applies as of the effective date of section 1374, unless the recognition period with respect to the contributed asset is pursuant to an S election or a section 1374(d)(8) transaction occurring on or after December 27, 1994.

(2) *Certain inventory dispositions.* For purposes of section 1374(d)(2)(A), the inventory method used by the taxpayer for tax purposes (FIFO, LIFO, etc.) must be used to identify whether goods